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VIA E-MAIL: regcomments@ncua.gov

October 29, 2007

Ms. Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: NCUA's Advance Notice of Proposed Rulemaking on FCU and Corporate Credit Union Foreign Currency Investments

Dear Ms. Rupp:

This letter is submitted on behalf of the Credit Union National Association in response to the agency's Advance Notice of Proposed Rulemaking (ANPR) on revising 12 C.F.R. Parts 703 and 704 to permit Federal credit unions and corporate credit unions to invest foreign currency in deposits and instruments in federally insured, U.S.-domiciled banks and corporates and in the debt obligations of U.S. government sponsored enterprises (GSEs). By way of background, CUNA represents approximately 90 percent of our nation's 8,400 state and federal credit unions, which serve nearly 87 million members. The views reflected in this letter are based on the deliberations of the CUNA International Legislative, Regulatory, and Operations Subcommittee, as well as comments we have received from credit unions and leagues.

Summary of CUNA's Views

- NCUA should initiate an investment pilot program for credit unions before proceeding to a proposed rule. A pilot program is preferable because foreign currency investment is a new power that credit unions do not have experience with and that only a small number of credit unions are likely to exercise. Safety and soundness concerns also support a pilot program because credit unions that already accept foreign currency deposits need investment powers immediately in order to balance the exchange risk.
- The foreign currency investment pilot program and subsequent rule should reflect the foreign currency risk management policies applied by OCC to national banks. OCC permits a national bank to develop foreign currency policies and goals that are tailored to the needs of the bank's customers and business model.
- NCUA should follow the example of OTS, which has opted for informal procedure instead of rulemaking to authorize thrift foreign currency investments as well as thrift cross-border activities.

- The investment pilot program should involve some foreign investments and foreign currency denominated lending because the limited investment powers proposed in the ANPR may be overly restrictive and impose an economic hardship on credit unions.
- NCUA should evaluate country risk on a country-by-country basis because some foreign countries are as politically and economically stable as the United States is.

NCUA Should Initiate a Pilot Program before Proceeding to a Proposed Rule

CUNA strongly supports the ability of federally insured credit unions that are able to manage associated risks to engage in foreign currency investments. However, rather than adopting a regulation to permit such activities at this juncture without the benefit of input based on credit unions' practical experiences, we believe it would be preferable to first authorize a pilot program.

In September 2006 the Board amended 12 C.F.R. § 745.7 to permit NCUSIF-insured credit unions to accept shares denominated in foreign currency but did not authorize foreign currency investments or lending. Credit unions accepting such deposits face foreign exchange risk exposure without being able to engage in these complementary activities. To address this imbalance and potential safety and soundness concern, NCUA is contemplating the development of a new regulation, the first step in which is the ANPR.

We believe a better approach for both the agency and the small number of credit unions likely to be interested is to initiate a pilot program that would allow foreign currency investments as well as lending in foreign currencies.[1] This approach would benefit NCUA because the agency could avoid the time-consuming, costly process of developing a new rule that would likely apply to but a handful of credit unions. The pilot will also allow NCUA to address issues as they occur without having to go through a subsequent process of amending a regulation should the agency find it necessary to change its approach.

The limited number of credit unions involved with foreign currency transactions would benefit because NCUA would be able to authorize investments much more expeditiously than it could under a rulemaking process that would entail analyzing the comments from the ANPR, developing a new proposal, seeking and assessing further comments and drafting and approving a new final rule. In addition, a lengthy rulemaking process would delay the ability of credit unions to control for foreign exchange risk associated with share deposit liabilities that they already have on their books. Proceeding with rulemaking without first giving investment authority to these institutions as part of a pilot program is potentially unsafe and unsound because these institutions would remain subject to exchange risk until the Board adopts a final rule.

Also, regulations are intended to be broadly applicable. While more credit unions may need to make foreign currency investments in the future, the small number that would

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[1] *See* pages 6 and 7 of this comment letter for a discussion of foreign currency lending activities.

currently take advantage of this authority does not justify the cost and effort of a process that will result in a broadly applicable rule.

A pilot program would also afford NCUA and credit unions more flexibility in crafting a regulatory regime that is appropriate for these activities. Since foreign currency investments are a new business activity to credit unions, the economic realities may be materially different from those on which the ANPR is premised. Discovering the nuances of foreign currency investment as part of a pilot program is preferable to discovering those nuances only after the Board has adopted a rule. A pilot program can be revised as circumstances dictate, while a rule requires a formal process to effect changes.

Policies and Procedures to Control Risks

The pilot program and subsequent rule should reflect foreign currency risk management policies similar to those applicable to national banks, as discussed below in greater detail under the risk categories. The Office of the Comptroller of the Currency, which has had decades of experience with national bank cross-border and foreign exchange operations, permits national banks to develop tailored programs and set their own foreign exchange limits and other risk-controls. The Office of Thrift Supervision has instituted similarly flexible foreign currency policies for thrifts. OCC permits each national bank to develop its own policies and goals because the risks in foreign currency investment vary considerably depending on the currency and the foreign country involved.[2] OCC requires that management "be able to defend logically the basis on which such policies are formed," but gives management leeway to develop policies that are appropriate for its institution.[3]

We see no public policy reason why NCUA should not adopt a policy similar to OCC's under which credit unions could develop their own institutional foreign currency policies and goals that would be subject to NCUA scrutiny. The foreign currency needs of one particular credit union's field of membership may be fundamentally different from the needs of a different credit union's field of membership. One group of members may need a wide range of foreign currencies while other groups may need only a few services in a limited number of currencies.

Credit unions wishing to engage in foreign currency services that are able to manage the risk appropriately should be able adopt policies that meet the needs of their members just as national banks are permitted to develop their own foreign currency policies based on the needs of their customers.

Regardless of whether NCUA chooses to authorize a pilot program or pursue a new regulation, the Board should permit credit unions to develop their own individual foreign currency policies and goals that reflect the needs of their members. We note that the

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[2] *See* OCC, *Comptroller's Handbook* § 813 (1990). Some aspects of national bank cross-border operations are governed by 12 C.F.R. pt. 28 but OCC has not promulgated foreign investment regulations other than to authorize national banks to engage internationally in any banking activity that is otherwise authorized for national banks and is also usual in connection with banking in the foreign country in question. 12 C.F.R. § 28.4.

[3] *Id.* at 7.

ANPR contemplates NCUA approval prior to a credit union engaging in foreign currency activities; this is consistent with a pilot program under which NCUA would have greater latitude to devise appropriate policies for credit unions than it would under a static regulation.

Exchange Rate Risk

As the ANPR notes, credit unions maintaining a balance between foreign currency denominated assets and foreign denominated deposits must control for foreign exchange risk. NCUA should adopt an exchange rate risk policy that is similar to that for national banks. The OCC has established a flexible exchange risk limit policy under which national banks establish foreign exchange limits for each of its customers based on each customer's creditworthiness and the volume of that customer's foreign currency needs. Based on the aggregate needs of its customers, a national bank must establish aggregate overnight net foreign currency position limits and must establish a written policy and goals for assessing exchange rate risk and associated risks.

Credit unions should be permitted to address exchange rate risk and any corresponding foreign currency limits in a manner similar to that of national banks. While a ten percent of net worth out-of-balance limit—the example cited in the ANPR—would be appropriate for certain credit unions, arbitrary limits may hamper the ability of other credit unions to serve their members. Market conditions or membership needs will necessitate credit unions remaining nimble to adjust their positions as conditions warrant; a limitation that must be changed by regulation would be a considerable competitive disadvantage for credit unions. NCUA should consider a more flexible out-of-balance policy that, like the OCC's policy for national banks, allows a credit union to propose its own out–of-balance limit, consistent with safety and soundness, which accurately reflects the risk posed to the institution and its members' needs. The policy should also be consistent with Financial Accounting Standard Board issuances, such as Statements No. 52 and No. 89.

Credit Risk and Liquidity Risk

As with exchange rate risk, credit unions should be allowed to establish credit risk policies that reflect their risk tolerance and the needs of their members, just as national banks do with respect to their customers. NCUA should not impose an arbitrary limit on member credit ratings applicable to all institutions. Each credit union should be allowed to develop its own credit risk guidelines for its member's foreign exchange needs so long as the credit risk policy is safe and sound and can be justified to NCUA.

Liquidity risk could be controlled by limiting a credit union's holding in currencies that are not readily marketable on major currency exchanges. Liquidity risk for currencies that are readily marketable on major currency exchanges does not likely need to be subject to a separate control so long as the credit union has appropriate internal controls and, if necessary, a realistic exit strategy for divestiture of a troubled readily marketable currency in a prompt and efficient manner.

Exit Strategy

Appropriate exit strategies may differ significantly depending on the credit union's goals and the exact currencies or countries involved. A credit union should develop a foreign currency exit strategy that makes sense for the institution's foreign currency exposure.

This issue would be best addressed on a case-by-case basis as part of the credit union's written foreign currency policies and goals if an exit strategy is necessary per se. NCUA does not require specific exit strategies for other types of credit union investments and foreign currency investments also may not warrant a specific exit strategy. This would be one of several issues that a pilot program could help sort out.

In the event that a credit union converts a member's account from being denominated in a foreign currency to being U.S.-dollar denominated, the credit union should be permitted to notify the member in a reasonable manner consistent with due process. It may be that the mechanics of member notice and under what circumstances a credit union can convert the account's currency is an issue best resolved at the time that the member opens a foreign currency account.

Information Systems and Technology Risks,

Credit unions should be able to demonstrate adequate information system capacity and management of technology risks prior to NCUA approval to engage in foreign currency investment. The credit union should detail its information system's ability to properly account for foreign currency investments as part of its proposed policies and goals submitted to the agency. Those policies and goals should also address technology risks.

Internal Controls

A credit union's proposed foreign currency activities should be subject to internal controls that the credit union proposes as part of its request to engage in foreign currency activities. NCUA rules for member business loans codified at 12 C.F.R. § 723.5 could provide a framework for foreign currency investment internal controls. NCUA should also look to the internal controls guidelines proscribed by the Federal Reserve Board, OCC, Office of Thrift Supervision and Federal Deposit Insurance Corporation to determine minimum standards for documentation, accounting, and auditing for foreign exchange operations. NCUA's internal control guidelines should reflect the state of the art in foreign currency internal controls and the individual needs of each credit union.

OTS Has Used Informal Procedure to Permit Thrifts to Conduct Similar Activities

OTS has allowed the thrift industry to participate in foreign currency lending and investment activities since the mid-1990s without using a rulemaking process. OTS authorized thrift foreign currency investments and other international activities under its incidental powers doctrine and legal opinion letters.

OTS has permitted federal savings associations to engage in a wide array of foreign currency and other international activities even though the Home Owners Loan Act does not expressly authorize thrifts to do so. In 1995, the OTS Chief Counsel issued a letter that permitted thrifts to invest in foreign currency-denominated CD and certain foreign currency bonds and debentures pursuant to the Home Owners Loan Act's incidental powers clause.[4] That same year, the OTS Chief Counsel issued a separate letter that

[4] OTS, Letter of Chief Counsel, Carolyn J. Buck, "Authority of Federal Savings Associations to Offer Foreign Currency Exchange Services" (Aug. 11, 1995).

allowed thrifts to make loans on the security of foreign real estate.[5] In 2000, the OTS Chief Counsel interpreted the Home Owners Loan Act to permit thrifts to issue debt securities denominated in foreign currencies as a method of selling loans originated by those institutions[6] and authorized thrifts to sell currency exchange forward contract to their borrowers.[7] The OTS Chief Counsel has also authorized thrifts to invest in the sovereign debt securities of foreign governments,[8] conduct some foreign activities, such as foreign currency exchange, through thrift service organizations,[9] and also authorizing thrifts to own foreign operating subsidiaries.[10]

Thrifts are neither subject to the International Lending Supervision Act, 12 U.S.C. §§ 3901-3911, nor the Federal Reserve's rules governing international banking operations codified at 12 C.F.R. pt. 211 ("Regulation K"). The International Lending Supervision Act and the Fed's Regulation K apply to commercial banks and bank holding companies and do not apply to thrifts or credit unions. While OTS looks to Regulation K for guidance on the narrow issue of whether or not it should permit a foreign bank to acquire control of a U.S.-domiciled thrift,[11] OTS has not promulgated regulations to address most thrift foreign currency or international activities issues.

OTS's regulatory flexibility exhibited by authorizing international thrift activities without rulemaking has allowed the thrift industry to develop foreign currency services that meet the needs of thrift customers. Had OTS promulgated a set of restrictive regulations in the mid-1990s rather than issuing opinion letters, it is possible that undue regulatory burden would have limited the thrift industry's ability to meet its customers' foreign currency needs.

A Pilot Program Should Include Foreign Investments and Lending

In addition to federally insured deposits and GSE debt obligations, NCUA should permit loans to members denominated in stable foreign currencies and, possibly, in sovereign debt or deposits in well-regulated government-insured depository institutions in certain countries. The extremely limited investment powers suggested in the ANPR may be insufficient or place an economic hardship on the credit union because of the extremely small number of FDIC-insured institutions accepting non-U.S.-dollar denominated deposits and the poor rates of return offered on those products.

EverBank, a Jacksonville, FL-based FDIC-insured thrift, is one of the few federally insured institutions to advertise that it accepts foreign currency deposits. Its savings

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[5] OTS, Letter of Chief Counsel, Carolyn J. Buck, "Foreign Mortgage Lending and Mortgage Consulting Services" (May 10, 1995).
[6] OTS, Letter of Chief Counsel, Carolyn J. Buck, No. P-2000-2, "Foreign Currency Denominated Debt Issuance" (Feb, 1 2000).
[7] OTS, Letter of Deputy Chief Counsel, Deborah Dakin, No. P-2000-5, "Currency Exchange Forward Contracts" (Apr. 3, 2000).
[8] OTS, Letter of Acting Chief Counsel, Carolyn Lieberman (June 18, 1993).
[9] *E.g.*, 12 C.F.R. § 559.4 (listing thrift service organization activities that OTS had previously approved on a case-by-case basis through opinion letter rulings).
[10] OTS, Memorandum from Chief Counsel, Carolyn J. Buck, No. P-2000-1, "Notice to Establish Operating Subsidiaries" (Jan. 14, 2000)
[11] *See* 12 C.F.R. § 574.7.

rates[12] are lower than the rates available for stable sovereign debt and may be too low to represent an acceptable rate of return for a financial institution.

Taking Euros as an example, EverBank currently offers an interest rate of only 3.00% on a Euro-denominated 12-month CD and only 0.63% interest on a Euro-denominated money market account (and then only if the account has a balance over € 60,000, which is near or above the $100,000 FDIC deposit insurance coverage threshold). Deposits in some currencies, such as the Japanese yen, currently yield no interest at EverBank no matter how large the deposit or the duration of a time deposit.

In contrast, the percentage yield on most Euro-denominated government bonds is between 3.9% and 4.4% depending on the issuing nation and the duration of the bond. The yield on yen-denominated Japanese government bonds is 0.81% for a two year bond, 1.1% on a five year bond, and 1.6% on a ten year bond. Deposits in well-regulated foreign banks in politically and economically stable countries would also generally provide a more appropriate rate of return on deposits than EverBank does. Deposits in well-regulated banks in stable foreign countries do not typically present greater safety and soundness concerns than uninsured deposits in a U.S.-domiciled institution present. Some credit unions already have maintained such accounts without incident.

A credit union making loans to its members in the foreign currencies the institution accepts as shares would also allow the credit union to achieve an appropriate rate of return. Making foreign currency loans to members would be consistent with the history of credit unions accepting shares in order to make loans. Lending in the currencies accepted for shares is the most natural hedge against exchange risk.

We recommend that NCUA should consider adding stable sovereign debt and deposits in well-regulated foreign depository institutions as possible credit union investment powers. NCUA should also allow credit unions to make loans denominated in foreign currencies.

NCUA Should Evaluate Country Risk on a Country-by-Country Basis

Permitting credit unions to make foreign currency investments and loans as part of a pilot program would be safe and sound so long as any cross-border loans and investments involve politically stable countries and stable payments systems. The ANPR proposes limiting credit union foreign currency investments to U.S-domiciled institutions because of concerns about credit union "exposure to the potential instability of a foreign country" and "settlement risks arising from international payments systems." These risks are not significant if the investments or loans are in countries that are at least as stable politically and economically as the United States, and which also use payments systems that are as sound as those in the United States.

According to 2006 World Bank figures—which use six categories to measure a nation's quality of governance ("Voice and Accountability," "Political Stability," "Government Effectiveness," "Regulatory Quality," "Rule of Law," and "Control of Corruption")—the

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[12] Other FDIC-insured banks and thrifts, such as Cathay Bank and Union Bank of California, advertise that they accept foreign currency deposits but do not advertise the amount of interest paid on those deposits.

following 15 countries rank in all six governance categories as either (a) superior to the U.S.'s ranking in that category or (b) in the top 10 percent of all nations in that category (if not superior to the U.S.'s ranking in that category): Australia, Austria, Canada, Denmark, Finland, Germany, Ireland, Iceland, Luxembourg, the Netherlands, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom.

Permitting credit unions participating in a pilot program to engage in circumscribed foreign currency lending or deposit investment in one or more of the above-listed 15 countries would be safe and sound and would give NCUA and the credit unions involved valuable insight into the mechanics of credit union foreign currency operations. Investment in the above-listed countries would not incur more political risk than investing in the United States because the above-listed nations are as stable as the United States. These nations also use reliable international payments systems such as SWIFT that pose no more risk to credit unions than U.S. payments systems do.

Investments or loans in many other nations would also likely be safe and sound, even if those nations do not rank in all six World Bank Governance categories as either superior to the United States or, if not superior to the United States, in the top 10 percent of all nations. France, Italy, and Japan, for example, are not more highly ranked than the United States or in the top 10 percent of the world for all six World Bank governance categories. France, Italy, and Japan, however, are all politically and economically stable nations with well-developed financial infrastructures and payments systems where credit union investments or loans would likely be safe and sound.

While a country should not need to be more politically stable than the United States for a credit union to make a foreign currency investment or loan, NCUA should evaluate each nation's political and other country risks on a country-by-country basis using data and analysis from other federal government agencies as well as from the World Bank, the United Nations, the International Monetary Fund, and other international institutions.

Conclusion

Credit unions engaging in foreign currency activities will face new issues and obstacles, many of which would be better addressed on a case-by-case basis as part of an investment and lending pilot program than with an inflexible rule promulgated without industry experience. A pilot program will give credit unions and NCUA valuable experience to use in promulgating a rule on foreign currency investments and loans should one prove necessary. As OCC and OTS have proven, specific regulations tailored to foreign currency investment are not necessary when the institution proposing to engage in foreign currency activities develops its own written policies and goals and is able to justify those policies to the appropriate regulator.

Thank you for the opportunity to comment on this Advance Notice of Proposed Rulemaking. If you or other Board staff have questions about our comments, please give me, Mary Dunn, or Michael Edwards a call at (202) 508-6705.

Sincerely,

Eric L. Richard
Executive Vice President and General Counsel